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HPQ - Q4 2012 Hewlett-Packard Earnings Conference Call

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OVERVIEW:

HPQ reported 4Q12 revenues of \$30b, operating profit of \$3.1b, and GAAP loss per share (including certain items) of \$3.49. Full-year 2012 GAAP loss per share (including certain items) was \$6.41. Expects FY13 GAAP EPS to be \$2.10-2.30 and 1Q13 GAAP EPS to be \$0.34-0.37.



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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the fourth quarter 2012 Hewlett Packard earnings conference call. My name is John and I'll be your conference moderator for today's call. At this time, all participants are in a listen only mode. We will be facilitating a question and answer session towards the end of the conference.

(Operator Instructions)

As a reminder, this conference is being recorded for replay purposes. I would now like to turn the presentation over to your host for today's call, Mr. Rob Binns, Vice President of Investor Relations. Please proceed.

Rob Binns - *Hewlett-Packard Company - VP, IR*

Good morning. Welcome to our fourth quarter 2012 earnings conference call with Meg Whitman, HP's Chief Executive Officer, and Cathie Lesjak, HP's Chief Financial Officer. Before handing the call over to Meg, let me remind you that this call is being webcast. A replay of the webcast will be made available shortly after the call for approximately one year.

Some information provided during this call may include forward-looking statements that involve risks, uncertainties and assumptions. If the risks or uncertainties ever materialize or the assumptions prove incorrect, the results of HP may differ materially from those expressed or implied by such forward-looking statements and assumptions. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements including, but not limited to, any projections of revenue, margins, expenses, earnings, earnings per share, tax provisions, cash flows, share repurchases, currency exchange rates, the impact of acquisitions, or other financial items. Any statements of the plans, strategies and objectives of management for future operations, any statements concerning the expected development, performance, market share, or competitive performance relating to products and services, and any statements of assumption underlying any of the foregoing.

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A discussion of some of these risks, uncertainties and assumptions is set forth in more detail in HP's SEC reports, including its most recent Form 10-Q. HP assumes no obligation and does not intend to update any such forward-looking statements. The financial information discussed in connection with this call, including any tax related items, reflect estimates based on information available at this time and could differ materially from the amounts ultimately reported in HP's 2012 Form 10-K.

Revenue, earnings, operating margins and similar items at the Company level are sometimes expressed on a non-GAAP basis and have been adjusted to exclude certain items including, amongst other things, amortization of purchased intangible assets, restructuring charges and acquisition related charges. The comparable GAAP financial information and a reconciliation of non-GAAP amounts to GAAP are included in the tables and in the slide presentation accompanying today's earnings release, both of which are available on the HP Investor Relations web page at www.HP.com.

And now I'll turn the call over to Meg.

Meg Whitman - Hewlett-Packard Company - CEO

Thank you, Rob, and thanks to all of you for joining us today. As we discussed, during our security analyst meeting last month, fiscal 2012 was the first year in a multi-year journey to turn HP around. We know where we need to go. We have a plan to get there and we have already made significant progress towards our goal. In our first year of the turnaround, we focused on four things, our customers, our people, our products, and our performance. We've put a strong leadership team in place and we are investing in systems and tools that are making it easier for us to manage our business, allocate resources and prioritize investment dollars. This has included the largest and fastest implementation of salesforce.com with more than 16,000 users already online. On May 23, we announced a multi-year restructuring program to streamline the organization and create the capacity to invest in innovation. At the end of fiscal 2012, we are on track to realize the savings that we laid out.

We have taken steps to refocus our R&D efforts, to extend HP's technology leadership in our core markets. Our product and service development teams have moved aggressively to better understand customer needs, to align our portfolio, and speed our time to market. We recently announced Martin Fink, as our new Head of HP Labs, and he is focused on driving better connections with the business groups product road maps and speeding the commercialization of our innovations.

We are already seeing tangible proof that the actions we've taken in 2012 are working. This is a landmark quarter for new product announcements including our first new line of multi-function printers in seven years, an impressive new line of Windows 8 PCs and the launch of the world's first tablet optimized for the enterprise. We also announced the industry's first open standards based software defined network technologies enabling enterprises and cloud providers to simplify and maximize agility across their networks, and we updated our enterprise security portfolio with scalable solutions that gives customers the 360-degree view needed to protect the 21st century enterprise.

Now cash flow is the life blood of any successful Company, and HP generated \$4.1 billion in cash flow from operations on \$30 billion in revenue for the fourth quarter, and \$10.6 billion for fiscal 2012. To put that number in context, \$10.6 billion is more than some of the most respected companies in the world such as Coca Cola, Disney, FedEx, McDonald's and Visa generated operating cash flow in their most recent fiscal years. HP used that cash to make significant progress on rebuilding our balance sheet, reducing our net debt by more than \$3 billion in the fourth quarter. We also returned \$384 million to shareholders in the form of share repurchases and dividends.

Most importantly, we did what we said we would do in fiscal year 2012. We delivered non-GAAP EPS of \$1.16 for the fourth quarter, a decline of only 1% over the prior year which highlights that the actions we have taken to bring our costs in line with the business are working. For the full year, we delivered \$4.05 per share, above the at least \$4 per share outlook that we gave in November 2011.

We also announced a number of significant customer wins in the quarter. General Motors completed a significant five year license deal with HP software to provide a comprehensive solution, including HP's industry leading IT performance suite, enterprise security suite, Vertica, and Autonomy software. This was a tremendous win and represents the largest deployment of HP software anywhere in the world.

Proctor and Gamble awarded HP a significant contract for HP applications development, management services, including our strategic enterprise services. These services will help P&G reduce costs, improve quality and drive innovation. Australia's Leighton contractor awarded HP a four year

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total printing solution contract. The program includes a comprehensive suite of services, software solutions, supplies, and hardware for over 180 sites across the South Pacific.

Now, let me turn to our business group performance in the fourth quarter. Overall, the disciplined approach to capturing savings from the consolidation of our IPG and PSG groups has started to pay dividends. The printing group had a strong quarter, both in terms of execution and profitability. We saw continued success in our ink advantage program which has now rolled out to 82 countries. In the fourth quarter, ink advantage hardware shipments grew 98% over the prior quarter and had a favorable impact on margins for our hardware sales. In Q4 we gained share in our focus areas of the printing market, including the high end with color and MFP units.

As we move into FY '13, we are continuing to drive product innovation in this category with our office jet products as part of our ink in the office program, featuring our breakthrough page wide technology. In addition, our new laser MFP printers are off to a great start and we expect all of these new products to ramp through fiscal 2012. Our focus on this high end category will remain, although we are working on the products, competitively priced for the lower end of the market. At the same time, we will maintain our disciplined approach to inventory and cost management.

In the fourth quarter our personal systems group faced weak demand and a challenging competitive environment with very aggressive pricing, impacting our profitability. Despite these headwinds, we were able to maintain our number one position in global PC sales. We also recovered market share in Asia to claim the number two position in the region with unit share gains in China. During the fourth quarter, we rolled out an impressive line of computing devices with form factors targeting both enterprises and consumers featuring Windows 8. In addition, we've begun the largest seed program in the history of the Company with the rollout of our new ElitePad 900 tablets to 1,300 customers.

As we move into the first quarter, we are managing the business tightly through disciplined inventory and cost management and what we expect will continue to be a challenging environment. In enterprise servers, storage and networking, we have seen continued strength in our 3PAR and HP networking businesses. This was offset by ISS which continued to face a very challenging macroeconomic and competitive environment that we believe will continue as we enter fiscal 2013. HP networking once again experienced double digit growth in the quarter after normalizing for divestiture, its 12th successive quarter of growth. This performance was driven by positive traction in nearly all regions around the world.

In storage, we continue to manage the transition to converge to the storage products. Once again, 3PAR had high double digit growth and EVA plus 3PAR was up 10% over the prior year, offset by the expected decline in tape. I am really excited about the new products that we'll be rolling out over the next few quarters that will continue to accelerate the growth of this business.

Our server business saw double digit growth again in Hyperscale, but this business is putting pressure on our overall ESSN margins. Our Gen 8 rollout continues to track positively, although we saw pressures on our pricing and margins as we work to improve our channel execution. We've introduced a number of changes to address immediate concerns and will rollout additional changes that we expect will deliver improved execution throughout fiscal year '13.

Finally, we are seeing strong growth in our cloud systems business. HP cloud systems is the industry's first complete, integrated and open cloud platform that enables customers to build and manage technology services across traditional, private, managed, and public cloud environments. We continue to grow our customer base which now stands at over 850 customers. In services, margin performance in the fourth quarter was above the FY '12 outlook range that we previously provided due to improved cost and resource management and improvement in our targeted, under performing accounts. For the full year, services margins were 11.7%, within our previously provided 10% to 12% range. We are making progress on our turnaround for this business and executing against the planned focused areas of resource management, accountability, market coverage, and better management of under performing accounts.

We also continue to see positive bookings and revenue growth in our strategic enterprise services business which includes cloud, application modernization, security and information management, and analytics. Looking to the first quarter, we expect that headwinds from revenue run-off will impact performance, causing margins to drop in line with the expectations we highlighted at our security analyst meeting.



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In our software business, we announced HP service anywhere, a cloud-based SaaS IT service management solution that helps companies manage their IT help desks. Overall, we saw SaaS bookings grow at mid double digit rates in the fourth quarter. HP software also saw continued strength in big data analytics with triple digit growth in Vertica and double digit growth in security as we rebuilt momentum in that business.

Autonomy remains a work in progress as we move this business from start up to grown up. There is a big market opportunity for this business but operational improvements are needed to take full advantage of these opportunities. While we expect these efforts will improve the future of our Autonomy business, we announced today an \$8.8 billion non-cash impairment charge related to Autonomy. Let me spend a moment giving you some detail about the situation. The majority of this impairment charge is linked to serious accounting improprieties, disclosure failures, and outright misrepresentations that occurred prior to HP's acquisition of Autonomy and the associated impact on the expected financial performance of the business over the long term. The balance of the impairment charge is linked to the recent trading value of HP stock. These improprieties were discovered through an internal investigation after a senior member of Autonomy's leadership team came forward following the departure of Mike Lynch on May 23.

Based on this information, HP initiated an intense internal investigation into the allegations, including a third party forensic review of Autonomy's historical financial results. HP has contacted the SEC's Enforcement Division and the UK's Serious Fraud Office. We have requested that both agencies open criminal and civil investigations into this matter. In addition, HP intends to seek reparation against various parties in the appropriate civil courts to recoup what we can for our shareholders.

I want to stress that we remain 100% committed to Autonomy and its industry leading technology. We will continue to fully support our new and existing customers and we believe Autonomy's technology will play a significant role in our growth strategy over the long term. To that end, we recently announced Robert Youngjohns as Senior Vice President and General Manager of our Autonomy IM business unit. Robert is a seasoned software executive who was most recently President of Microsoft North America.

Now, let me turn to our fiscal first quarter and future outlook. As we discussed at our security analyst meeting, turning HP around is going to be a multi-year journey and will not be linear. Fiscal 2013 is going to be a fix and rebuild year for the Company as critical changes to our organizational structure take hold. We will continue to drive product innovation in our core markets, improve our commercialization strategy with a focus on cloud, security, and information optimization, and rebuild our go to market capability. At the same time, we expect the underlying macro and industry headwinds to continue as we enter 2013. This will put pressure on our top line performance. Finally, the turnaround plan we laid out during our security analyst meeting for our services business will have a positive ramp as we move through 2013.

As I spoke about at SAM, we expect to see real growth in each of our businesses in 2014 as they ramp through 2013. This is because the new products and services we're working on will kick in. Our investment in R&D and IT will begin to pay off. We'll have another year of cost management under our belt and demonstrated our ability to manage costs in line with revenues. Our enterprise services business will have stabilized and will begin to grow again, and our capital structure will have improved as we continue to pay down debt. We expect that growth will accelerate as we enter FY '15 and beyond. These are real challenges and we don't take any of them lightly but we're committed to dealing with these challenges head on and in a transparent way. HP has incredible assets and world class talents and I know we can turn this company around.

Given the factors above, our outlook for Q1 is \$0.68 to \$0.71 for non-GAAP earnings per share. We expect the benefits from our restructuring and other cost management activities will accelerate as we move through fiscal 2013, maintaining our confidence in our previously stated full year range of \$3.40 to \$3.60 per non-GAAP earnings per share.

With that, I'd like to turn it over to Cathie to provide more detail on the quarter.

Cathie Lesjak - Hewlett-Packard Company - CFO

Thank you, Meg. I'll review the fourth quarter performance and then close with our outlook. In the fourth quarter, revenue was \$30 billion, down 7% year-over-year as reported and down 4% in constant currency. We continue to see macroeconomic challenges in each of our regions.

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In the Americas, revenue was \$13.5 billion, down 6% year-over-year as reported and down 5% in constant currency. Revenue in EMEA was \$10.7 billion, down 8% year-over-year and down 4% in constant currency. And revenue in Asia Pacific was \$5.7 billion, down 4% year-over-year and down 3% in constant currency. The US fared relatively better than some of the other countries across the Americas while in EMEA, we experienced unrelenting pressure in Western Europe. Within APJ, we saw constant currency growth in China, Japan, and India. These are positive signs given the investments we have recently made to improve our market position in the region.

Non-GAAP gross margin of 24.2% was up 90 basis points year-over-year as favorable software mix and the increases in printing margins more than covered the competitive pricing environment for PCs and servers. The 80 basis point sequential improvement in gross margin was driven by improved services margins combined with favorable software mix, partially offset by continued competitive pricing for PCs and servers. Non-GAAP operating expenses were \$4.1 billion, down 5% year-over-year and down 2% sequentially. The restructuring program announced in May provided savings this quarter in line with our expectations and some of these savings are helping drive down our SG&A expenses. Non-GAAP operating margin was 10.4%, up 70 basis points year-over-year and the Company delivered \$3.1 billion in operating profit.

The bridge from non-GAAP operating profit to non-GAAP earnings per share includes the following. Other income and expense of \$188 million in expense, a tax rate of 22%, a 2% reduction in our weighted average share count to a 1.967 billion shares, and we used \$124 million in Q4 to repurchase 7.6 million shares. As a result, we delivered non-GAAP diluted earnings per share of \$1.16 and a GAAP loss per share of \$3.49. Fourth Quarter Fiscal 2012 GAAP loss per share includes after-tax costs of approximately \$4.65 per share related primarily to the impairment of goodwill, amortization and impairment of purchased intangible assets and restructuring charges. For fiscal year 2012, non-GAAP earnings per share was \$4.05, above the outlook of at least \$4 that we provided as we began the fiscal year. GAAP full year EPS was a loss of \$6.41 which included non-cash impairment write downs to goodwill and purchase intangibles of \$9.14 and other adjustments to GAAP results. Note, there is a detailed bridge in the earnings deck posted on the HP Investor Relations website.

Before I go into the segment details, let me quantify the components of the Autonomy writedown Meg just mentioned. Of the \$8.8 billion non-cash writedown, over \$5 billion is related to accounting improprieties, disclosure failures and misrepresentations that occurred prior to HP's acquisition of Autonomy and the associated impact on the financial performance of the business over the long term. The balance of the write down is linked to the recent trading of HP stock. Now turning to our business segments.

Personal systems delivered revenue of \$8.7 billion in the quarter, down 14% year-over-year, with an operating margin of 3.5%. Total units shipped were down 12% year-over-year in total and across both notebooks and desktops, as we saw weakness in both consumer and commercial sectors. By category, commercial revenue was down 13% year-over-year and consumer revenue declined 16% year-over-year. The margin contraction is indicative of the challenging market and pricing environment we face. In the quarter, we saw specific pressures as our competition cleared out their excess Windows 7 inventory ahead of the Windows 8 launch. We feel good about our Windows 8 inventory and the overall inventory story for personal systems was good in Q4.

We have work to do to get the margins of this business back to where we want them. As we have discussed before, we are focusing on getting the right products out to market with the appropriate number of SKUs and we need to drive these through our first class supply chain. We expect our progress to ramp as we move through fiscal '13.

Turning to printing. Net revenue was \$6.1 billion, down 5% year-over-year. We again realized share gains in high value ink hardware and across our multi-function portfolio and as Meg mentioned, we are also seeing positive momentum in our ink advantage program. Operating profit of \$1.1 billion was up 5.1 points year-over-year to 17.5% of revenue. Supplies were 66% of the mix, up three points year-over-year and within the supplies mix, we benefited this period from a favorable proportion of ink supply sales. Additionally, printing operating margins benefited this quarter from favorable currency hedging impacts that we don't expect to continue as we move into fiscal '13. The business did a good job of managing channel inventory with supplies down in dollar terms for the fifth quarter in a row. Overall channel inventory levels are within our acceptable ranges. Specifically with ink supplies channel inventory though, we will be continuing to reduce the level and we expect the total supply mix of revenue to decrease in Q1 accordingly.

By business unit, total printer unit shipment volume was down 20% year-over-year largely driven by the decline in consumer as we maintained focus on the higher value units. Consumer printer revenue was down 14% year-over-year with hardware units down 22%. Commercial printer

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revenue was down 13% and hardware units were down 15% year-over-year. The consumer results are largely driven by our focus on units that carry a positive lifetime return. Within the commercial space, we are excited about new product offerings we are introducing to the market, particularly with respect to the new MSP line up. In addition, we had a record quarter for Indigo in our graphics business and our management services saw healthy device and printed page growth.

Moving on to services. In the fourth quarter, services delivered revenue of \$8.7 billion, down 6% from the prior year and down 3% in constant currency. Operating profit of \$1.2 billion was 14.2% of revenue, up 1.1 points from the prior year. In the quarter, we saw benefits from our restructuring program, as well as normal Q4 seasonal increases in profit associated with project milestones. We continue to see strong sequential growth in our strategic enterprise services which includes cloud, application modernization, security, and information management and analytics.

IT outsourcing revenue of \$3.7 billion was down 6% year-over-year as we continue to scrutinize new deals and renewals for margin and strategic fit. Application and business services revenue was down 7% year-over-year at \$2.4 billion. Although revenue was down, we are seeing improvements in our ABS signings, both year-over-year and quarter-over-quarter. Technology Services revenue was down 4% year-over-year to \$2.6 billion, largely impacted by the declines in hardware. Within TS, we are driving penetration rate increases within storage, networking, and industry standard server offerings. As discussed at SAM, beginning in fiscal '13 we will be reporting Technology Services together with ESSN as part of our newly formed segment called the Enterprise Group. IT outsourcing and ABS will be reported within the new enterprise services segment.

Turning to enterprise server, storage, and networking, revenue of \$5.1 billion was down 9% year-over-year impacted by declines in server and storage overall with particular softness in EMEA. Operating profit was \$423 million and the operating margin of 8.3% was 4.5 points below the prior year period. Margin pressure was driven by a weak demand environment and a very aggressive pricing back drop. Now let's dive into ESSN performance by business.

In storage, the sustained strong performance of 3PAR was close to 60% growth and StoreOnce with double digit growth was impressive. Combined, 3PAR and EVA was up 10%. Overall, we are seeing a good mix shift towards our converged storage products based on our own intellectual property. This is a planned transition we have been executing for several quarters, but these growth areas were not enough to offset the declines in EVA, storage networking and tape revenue. As a result, total storage revenue was down 13% year-over-year.

Overall business critical systems revenue declined 25% year-over-year. Within BCS, mission critical X86 was up over 25% but the BCS performance was again impacted by the persistent Itanium revenue decline. Industry standard server revenue declined 7% year-over-year with particular weakness in EMEA. Networking revenue was up 7% year-over-year at \$635 million, or up 11% when normalized for a divestiture in Q1. We expect to maintain positive traction in this business as China and EMEA are showing strong growth.

Software revenue of \$1.2 billion was up 14% from the prior year period. License revenue was up 9% year-over-year and support and services each saw strong growth at 9% and 48% respectively, and we had our largest SaaS bookings quarter in history. Overall, fourth quarter operating profit for software was \$318 million, or 27% of revenue.

As we announced in October, General Motors made a decision to largely in-source its IT operating model. In conjunction with this, General Motors announced a new multi-year project services and software contract with HP. This was a significant deal in our Q4 software results as it represented the largest customer deployment of HP software in the world.

HP Financial Services revenue was up 1% year-over-year at \$966 million. Financing volume was down 11% and net portfolio assets increased 3% year-over-year to \$12.8 billion. Operating profit of \$104 million was up 50 basis points year-over-year to 10.8% of revenue. For the full year, the HP Financial Services return on equity was 17%.

Now on to capital allocation and the balance sheet. Operating cash flow was \$4.1 billion, up 69% year-over-year and free cash flow was \$3.5 billion. Total growth cash at the end of the quarter was \$11.8 billion. For the year, we generated \$10.6 billion of operating cash flow and \$7.5 billion of free cash flow. Improving working capital has been a focus area for us and I'm pleased with the results this quarter. The cash conversion cycle was 21 days, down five days year-over-year and six days sequentially. Inventory and accounts payable were sequential drivers of improvement, while we saw improvements across-the-board on a year-over-year basis. During the quarter we returned \$124 million in cash to shareholders via share



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repurchases, leaving roughly \$9.2 billion remaining in the authorized share repurchase program. We also paid \$260 million to shareholders through our quarterly dividend.

As we entered fiscal '12, we discussed how we would be disciplined in capital allocation to begin rebuilding our balance sheet. We've stayed true to our word. M&A activity has been minimal and share repurchases have been in line with guidance. At the same time, we still were able to distribute \$2.6 billion of capital in fiscal '12 to shareholders through buybacks and dividends and improve our net debt position by \$3.1 billion sequentially in Q4 and \$5.6 billion through the year.

On an operating company basis, our net debt position stands at \$5.8 billion at the end of Q4. We are pleased with our progress in getting our balance sheet in a stronger position and we will stay focused on reducing our operating company gross and net debt balances in fiscal '13.

Now turning to our outlook. We laid out the details of our fiscal '13 assumptions at our security analyst meeting and we're still comfortable with what we shared. Fiscal '13 will be a year of fix and rebuild for HP. The macro environment we described to you six weeks ago has been further substantiated since we last spoke and we continue to see a very difficult back drop as we move through the early part of fiscal '13. We have to continue to work to improve our operational execution, including renewed focus on working with our channel partners which will take some time to show up in our performance.

While we saw favorable profit results across some of the segments in Q4, we see headwinds as we move into Q1. We don't expect the printing margins to stay where they were in Q4 as we move into Q1, as we work to adjust our ink supply inventory levels and we also do not expect similar hedging gains to those that we saw in Q4.

In enterprise services, as we talked about at SAM, we are facing exceptional account run-off in the first half of fiscal '13 and we expect the sequential decline in operating margins in excess of normal seasonality. While we are optimistic about the new innovative designs we have launched in personal systems, the market conditions and acute pressures in the consumer space do not seem to be abating. And our server business continues to face tough macro and pricing pressures, particularly as we see the Itanium challenges within BCS persisting.

We have previously discussed key areas of operational focus such as supply chain, SKU simplification, business process reengineering and real estate. We expect the savings associated with these actions will be roughly half the labor savings from our previously announced workforce restructuring efforts in fiscal '13. We expect the benefits of these actions to be significant in the second half of '13. We expect that currency will be a headwind to revenue of approximately one percentage point year-over-year in Q1.

With that context, we continue to expect full year fiscal 2013 non-GAAP earnings per share to be in the range of \$3.40 to \$3.60. For Fiscal 2013 Q1, we expect non-GAAP earnings per share in the range of \$0.68 to \$0.71. From a GAAP perspective, we continue to expect full year GAAP earnings per share to be in the range of \$2.10 to \$2.30 and GAAP earnings per share for fiscal Q1 is expected to be in the range of \$0.34 to \$0.37.

With that, now let's open up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Ben Reitzes, Barclays.



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Ben Reitzes - Barclays Capital - Analyst

Yes, thanks a lot. Meg, with regard to the Autonomy situation, we understand what you're doing in terms of going after the folks that you feel misled you, but what about internally? Who's responsible internally for the acquisition? How are you analyzing yourself internally, the Board, I think everybody at the Board was there when the Autonomy decision was made, except for Mr. Whitworth.

So what's the introspective, what are you doing internally to make sure that you have the right processes and who are you holding accountable internally, if anyone, to make sure this doesn't happen again and that maybe even there's some folks internally that need to be held responsible and we could see repercussions of this in the near future? How are you looking at it internally?

Meg Whitman - Hewlett-Packard Company - CEO

Yes, well first of all, the CEO at the time and the Head of Strategy who lead this deal are both gone, Leo Apotheker and Shane Robison. With regard to the Board, you're right. Most of the Board was here and voted for this deal and we feel terribly about that. What I will say is the Board relied on audited financials, audited by Deloitte, not brand X accounting firm but Deloitte and, by the way, during our very extensive due diligence process, we hired KPMG to audit Deloitte, and neither of them saw what we now see after someone came forward to point us in the right direction.

That said, obviously, we have not done any big acquisitions and we will review the acquisition process. What I will say is due diligence now reports to our Chief Financial Officer. At the time when I came to the Company, I was surprised to find that due diligence and M&A reported to strategy as opposed to the Chief Financial Officer. I've never seen that before in my career and that's a decision I made right away before I knew any of this. So I understand your point of view and we have made a few changes in that regard but, in the end, you have to rely on audited financials and we did and we will now carry on and as you know, we've reported this to the SEC as well as the Serious Fraud Office and we will take it from here.

Ben Reitzes - Barclays Capital - Analyst

And in terms of internal personnel though, based on what you see right now, the organization can remain stable based on this occurrence?

Meg Whitman - Hewlett-Packard Company - CEO

Yes, it can. Really the two people that should have been held responsible are gone and that's the way I see it right now, so I feel good about sort of the stability of leadership.

Ben Reitzes - Barclays Capital - Analyst

Okay, thank you very much.

Rob Binns - Hewlett-Packard Company - VP, IR

Thanks for the question, Ben. Next question please?

Operator

Bill Shope, Goldman Sachs.



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Bill Shope - Goldman Sachs - Analyst

Okay, great, thanks. Can you give us a bit more color on what levels of restructuring savings you were able to capture this quarter? And in particular, which segments did the savings benefit most as I imagine you didn't have much ability to reinvest yet, and how should we think about the reinvestment plans in particular as we go into the first quarter and then as we get through fiscal 2013?

Cathie Lesjak - Hewlett-Packard Company - CFO

Thanks, Bill. So in terms of kind of which businesses benefited most, I think all of our businesses benefited to some extent in fiscal '12 from the restructuring efforts. Clearly, services, that is such -- has a heavy component to labor to it, probably had the absolute dollar biggest savings from the restructuring efforts. In terms of kind of the total magnitude, I think we laid it out in our earnings call last quarter and we basically talked about kind of \$0.05 to \$0.10 worth of savings in fiscal '12.

Meg Whitman - Hewlett-Packard Company - CEO

I'd add one thing to that. I think one thing we've been very pleased with is the merger, if you will, between our printing business and our personal systems group. This has simplified our go to market. We now have one decision maker in many countries for both our printing and our PC business. The customers are the same. The channel partners are the same, and we have seen a lot of savings and a lot more effective go to market here and we continue to see that go forward.

In terms of investments, we are very focused on product, product, product. Great companies return to greatness on the basis of product and we're excited about our overall product line up, whether that be our Gen 8 servers and our Moonshot servers or our new securities portfolio, or our new line of PCs or printers or services, and so the majority of incremental investment will go into making those products great and into R&D.

Cathie Lesjak - Hewlett-Packard Company - CFO

And then the other piece of the investment is really setting us up for some of the non-labor savings that I laid out in my prepared remarks around SKU reduction, business process reengineering, real estate and supply chain. So some of that is more in investment mode at the early part of fiscal '13 but does ramp in the latter half of '13.

Rob Binns - Hewlett-Packard Company - VP, IR

Great, thanks for the question, Bill. Next question, please?

Operator

Toni Sacconaghi, Sanford Bernstein.

Toni Sacconaghi - Sanford C. Bernstein & Company, Inc. - Analyst

Yes, thank you. I had a question and then a clarification, please. On the question, I was wondering, if I look at your guidance, you're guiding for sequential decline in EPS of 40% for fiscal Q1. Historically, in the last 15 years, you've only been down more than 10% once and you've never been down more than 23% sequentially, so you don't -- typically you're kind of flattish sequentially on a revenue basis or slightly down.

So I'm wondering, given that your savings actually should be ramping from your restructuring, I understand some of the competitive headwinds that you outlined, the financial headwinds in terms of both supplies and ISS but it's really hard to get the math there, so maybe you can shed a little bit more color on why the dramatic erosion in profitability for Q1 and what else underpins that?

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Meg Whitman - Hewlett-Packard Company - CEO

Yes, Toni, let me take a crack at that and I'll turn it over to Cathie. So the way I look at 2013 is we have a probably weaker than normal seasonality in the first half and stronger in the second half. Obviously the second half is always stronger but you're going to see the restructuring kick in, in the second half in terms of both labor and non-labor savings. Enterprise services, the biggest run-off in these accounts is actually in the first and second quarter, so you're going to see a disproportionate effect there.

In terms of our new products, many of those products are being introduced now so you'll see them really start to hit in Q3 and Q4, and some major hedging gains came off in the first quarter, so that's why you see some of the bigger difference than you referenced. So you obviously do see a second half that's going to be gaining strength. We've looked into this very carefully. I still feel very comfortable about our full year guidance but we've got some headwinds in the first quarter, some of which are out of our control like the hedging gains coming off.

Cathie Lesjak - Hewlett-Packard Company - CFO

Let me add just a couple more comments to that. So in terms of the quarter on quarter decline in revenue, we've got the normal seasonality that brings it down but then we have some extraordinary items such as the ES run-off that Meg referenced, but also, if you look at kind of what we experience in the macroeconomic environment over the course of Q4, it actually came down over the course of Q4. So our guidance basically says it stays roughly at where it exited Q4, which is driving quarter on quarter declines in revenue or continuing to see a very competitive pricing environment and we're continuing to see lower than normal revenue from our Itanium situation.

In addition, I mentioned in my prepared remarks the fact that we had a very significant software deal from General Motors and software that just simply is not going to repeat at nearly that level. And then finally, I'll mention that we do have to reset our incentive compensation plans given our new plan and that puts upward pressure on costs from Q4 to Q1.

Toni Sacconaghi - Sanford C. Bernstein & Company, Inc. - Analyst

Okay, if I could just follow-up on the workforce restructuring question from before, so you said that there would be, of the 29,000 jobs expected to be eliminated, 11,500 would be gone by the end of fiscal '12, implying almost 8,000 in fiscal Q4. Can you confirm that you received that?

Are you still expecting 26,000 employees to depart by the end of fiscal '13 and if statements are true, 8,000 people coming out in Q4 should have a significant sequential benefit in the first half of the year and why is that not being mentioned and you also said that you'd be getting about 50% incremental non-labor savings. I think your gross savings that you had outlined were \$0.80 so in savings so are you assuming another 40, we should be thinking about another \$0.40 in non-labor savings going forward?

Meg Whitman - Hewlett-Packard Company - CEO

So Toni, there are a lot of questions in there and I could answer yes, yes, non-labor is back end loaded but let me be a little bit more helpful than that. So yes we did get the headcount reductions that we were expecting exiting fiscal '12 of roughly 11,500. Yes, we are still expecting 29,000. Yes, we expect that by the end of fiscal '13 we will go down 26,000 people.

Now one of the things you have to keep in mind is that when we execute programs for labor reductions outside the United States, they take significantly longer time to complete and that's why a lot of the additional savings in labor is back end loaded for us. And then from a non-labor perspective, what we're really seeing is that we've got to make some of these are making investments in the front end of '13. We call them enabling investments that then pay off or start to pay off towards the end of '13.



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Toni Saccanaghi - *Sanford C. Bernstein & Company, Inc. - Analyst*

Thank you.

Rob Binns - *Hewlett-Packard Company - VP, IR*

Great, thanks for the question, Toni. Next question please?

Operator

Kathryn Huberty, Morgan Stanley.

Kathryn Huberty - *Morgan Stanley - Analyst*

Thanks, good morning. In the fiscal '13 EPS bridge you'd highlighted an assumption of roughly flat PC earnings and growing IPG earnings so the question is in light of the low PC operating margin, operating profit dollars were down almost 50% year on year in the fourth quarter and the over earning from the ink supplies in the back half of fiscal '12, which will be a tough comp next year. If you're still comfortable in flat to growing earnings in those two businesses, and if there ends up being risk on that front, what factors can you use to offset that as you move through fiscal '13? Thank you.

Meg Whitman - *Hewlett-Packard Company - CEO*

Yes, let me take that. So as we look at this, we're still comfortable with those estimates, although I will say the PC situation is pretty challenging right now and of course the way we're managing this business is the good news about the PC business is it is almost at 80% variable cost, so it is not a high fixed cost business. So if there are discontinuities in the revenue, we can recover from that to quite a large degree, but we also will look across the portfolio between our printing business, as well as our PC business, which is now all run as one business under Todd Bradley called PPS, to make sure that we deliver the operating income as we look across the whole portfolio.

So we're conscious of the pressure on the PC business. We're optimistic in that we have some great new products coming. We're optimistic about Windows 8. We're very optimistic about our ElitePad 900 which is the first tablet designed for the enterprise, but also conscious that we may have to manage that business as a whole to deliver the operating income that we expect.

Cathie Lesjak - *Hewlett-Packard Company - CFO*

And then the other thing I'd add is that a significant portion of the non-labor savings, when you think about SKU simplification and supply chain optimization, benefits both PCs as well as printers, so I think that we do have some levers, additional levers to manage our cost and in the PC business, as well as in the printing business, it really is about managing your operational costs day in and day out.

Rob Binns - *Hewlett-Packard Company - VP, IR*

Thanks, Katie. Next question, please?

Operator

Brian Alexander, Raymond James.



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Brian Alexander - Raymond James & Associates - Analyst

Cathie, could you talk about what specifically drove the 25% sequential decline in enterprise, hardware profitability? Looked like revenue was flat. I don't think I could remember a quarter with such a dramatic decline in enterprise margins and your product mix actually looked slightly favorable on a sequential basis, so was all of this pricing and why wouldn't your enterprise assumptions for your FY '13 waterfall be at risk given these results? Thanks.

Cathie Lesjak - Hewlett-Packard Company - CFO

So a lot of the softness in the operating margins really came from lower top line growth driven by soft macro demand, as well as a very aggressive pricing environment especially in Europe. But also, what's putting pressure on margins is the continued decline in business critical systems related to Itanium and the fact that our Hyperscale business is growing very well, but as we talked about, I think on the last call, Hyperscale margins are materially different than the industry standard average.

So I think one of the things we need to think about is how we look at this business on a longer term basis because we're really investing in the large growing and more profitable market segments like storage and networking and that's helping to offset, over time, the business critical systems decline and really getting then the mix effect from that. And also, the fact that we're coming out with what we consider pretty disruptive products in the Hyperscale space, specifically related to our Moonshot product which really helps us change the economics for ourselves, as well as the value proposition for our customers for Hyperscale. And so over the long term, we do expect these dynamics to help bring margins back up.

Meg Whitman - Hewlett-Packard Company - CEO

The other thing I'd add to that, Brian, this is Meg, is that one of the things we have to focus on is our mainstream industry standard server business which is the weak spot here, and we are doing a whole host of work around our channel relationships in that business, around supply chain improvements, reconfiguring some of the products to be more affordable to certain segments of the market. And I think Dave Donatelli has an excellent plan in place and he and his organization are going to execute against that in the first half and I think you'll see some improvements in the second half.

Cathie Lesjak - Hewlett-Packard Company - CFO

I think the only other thing I'd add to that is that from an investment perspective, in terms of R&D, this is one of the key areas where we are putting real dollars into R&D and are sustaining that. And so this kind of goes back to Meg's comment in her prepared remarks around the fact that this is not necessarily going to be a linear year and we are going to sustain the right level of investment to set HP up for the long term, and part of that really shows up in the ESSN group.

Rob Binns - Hewlett-Packard Company - VP, IR

Great, thanks for the question, Brian. Next question please?

Operator

Brian Marshall, ISI Group.



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Brian Marshall - *ISI Group - Analyst*

Thanks. If you look -- a question with respect to guidance. If you take the guidance at the mid point for the quarter about \$0.70, you take that as a percent of the fiscal year total, 350 at the mid point, that's 20% Q1 represents of the entire fiscal year. When you look at the previous three fiscal years, Q1 as a percent of the fiscal year is averaging about 25%. So what gives you the confidence for the following three quarters of the fiscal year that, that will actually come up and if you can get a little bit more granular with respect to the segments that would be helpful as well? The question is why aren't we lowering the fiscal year guidance with Q1 coming down here? Thank you.

Cathie Lesjak - *Hewlett-Packard Company - CFO*

It really all comes down to our view of the second half. We definitely see that the second half per normal seasonal trends is higher than the first half and we're seeing that is skewed even more as a result of the restructuring programs that we've talked about and the fact that, again, the non-US programs ramp later in fiscal '13, the non-labor components around SKU reduction, supply chain simplification, business process reengineering and real estate also have the investments on the front end and are starting to pay off in the second half of '13.

And then you really got to take into consideration the key contract run-off which is exceptional in enterprise services in the first half, the fact that we believe Autonomy will ramp more in the second half, that we're making adjustments to channel inventory in the first half and finally, it's really about all of our new products that are coming in. And the fact of the matter is that they don't really get significant traction until the second half of the year and we've got a number of new products, whether that's the different form factors that we've got leveraging Win 8, the new line up of multi-function printers, the ink in the office, taking ink in the office higher into the office with our new Office Jet Pro X product, that doesn't ship until February. So all of these are really contributing to a very different profile in the year from a revenue and profit perspective.

Meg Whitman - *Hewlett-Packard Company - CEO*

Let me just add, obviously when we gave guidance for Q1 we knew this was going to be a question, so we went through in quite some detail looking quarter by quarter, product by-product, business by business, channel partner by channel partner, top 250 customers by 250 customer, and feel comfortable around the 340 to 360. So I would add that we understand what your concern is, but we feel good about our 340 to 360 estimate.

Rob Binns - *Hewlett-Packard Company - VP, IR*

Thanks, Brian. Appreciate the question. Next question, please?

Operator

Steve Milunovich, UBS.

Steve Milunovich - *UBS - Analyst*

Thank you. Could you talk a bit more about the printer business and specifically, last quarter the margins were somewhat surprisingly high, I think, because you had more Inkjet sell in than sell-through so we sort of expected they might come down this quarter and obviously they did the opposite so maybe you can talk a bit more about what were the contributors to that and how much the hedging thing was and so forth. And also, are you concerned with the reduction in the hardware units at this kind of a pace that it's going to have a lag effect on supplies and how long does that lag typically take?



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Cathie Lesjak - Hewlett-Packard Company - CFO

Let me start with the specifics around the year on year and quarter on quarter improvements in the operating margins and then maybe Meg can take on the question around the hardware units and where we're focusing. So from a year on year and sequential perspective, the margin improvement really came from higher supplies mix and the mix within supplies is shifted a bit more to ink. We also have a lower mix of low value hardware so we really are focusing on higher value hardware which is driving ASPs up.

And then finally, we're benefiting from disciplined cost management and part of that is just a maniacal focus on cost and the restructuring benefits and then the other piece is just bringing the IPG and PSG groups together. It really has given us the kind of leverage that we had hoped for when Meg made the decision to bring the two groups together.

Meg Whitman - Hewlett-Packard Company - CEO

With regard to hardware, so let me take the ink hardware first. One of the things that we discovered in the last 12 months is that there's a very distinct segmentation between high end hardware and low end hardware. When you sell high end hardware in ink, typically those purchasers buy enough ink to offset the revenue loss, the operating loss, if you will, every time we sell a hardware unit. At the low end, oftentimes you put our hardware unit into the marketplace at a loss and the customer never buys enough ink to overcome that hardware loss, so we've been very disciplined about where we're gaining share and we gained share in the high end hardware units in ink that we wanted to.

Now, by the way, we're also looking at is there a low end ink hardware unit that we can develop that we can make more money on than we do today, so we're working on that, but we feel really good about our strategy. I'll also say, we expect our multi-function line up of printers, 16 new printers, to really kick-in in the second half of 2013. We've gotten great market response to that and we're feeling really good about that and you saw we gained share in multi-function printers. We expect that to continue.

And then the last thing is, as Cathie mentioned in her remarks, Indigo had a record quarter and this is taking advantage of the move from analog to digital, which I know that the printing group has talked about for many years at HP. I actually think we're seeing some of that, particularly in the Indigo space.

Steve Milunovich - UBS - Analyst

Thank you.

Rob Binns - Hewlett-Packard Company - VP, IR

Thanks for the question, Steve. Time for a couple more I think. Operator, next question please?

Operator

Kulbinder Garcha, Credit Suisse.

Kulbinder Garcha - Credit Suisse - Analyst

Thanks, just a clarification and a question. On the cost savings, maybe to ask the question a different way, can you just maybe answer of the \$3 billion to \$3.5 billion of savings that you were targeting to the end of '14, how many -- how much of that benefited HP in the last fiscal year? And then for Cathie, given the strong free cash flow \$7.5 billion last year and \$3.5 billion in the quarter, are you still guiding for \$5 billion of free cash flow only in fiscal year '13? Many thanks.

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Cathie Lesjak - Hewlett-Packard Company - CFO

So let me start with the cash flow question. So we are not updating our guidance or our outlook for cash flow for fiscal '13, but I think what is important to kind of take away from the results that we had in Q4 is that when we focus we achieve results, and we are focused on driving free cash flow for this company. And that means making our earnings, generating cash earnings out of that, focusing on our working capital and driving our cash conversion cycle and finally, really focusing on CapEx and making sure that every dollar of CapEx is returning its appropriate cost of capital or better, and so that is a renewed focus I would say in fiscal '13.

Meg Whitman - Hewlett-Packard Company - CEO

With regard to the cost savings, the cost savings focus in two areas, labor which we've talked about and that's the genesis, the restructuring charge and then non-labor, and Cathie gave you some additional color on the non-labor. And these savings, as Cathie mentioned, are non-linear, particularly in the labor side as we've said. As you know, making changes to your labor force in Western Europe is a real challenge and sometimes takes as long as 12 to 18 months to actually execute that change, but that's what we are doing. So we achieved the savings we thought we would in 2012 and we are on track for 2013, but I will say that labor savings in Western Europe is a real challenge but we're committed to it.

Rob Binns - Hewlett-Packard Company - VP, IR

Great thanks for the question. And time for one last question please, Operator?

Operator

Shannon Cross, Cross Research.

Shannon Cross - Cross Research - Analyst

Thank you very much. I just want to return to Autonomy. Could you provide some details on the steps and timing of your pursuit of remedies from Autonomy and other parties, just sort of what should we expect, what have your lawyers told you and how is this process going to work itself through?

Meg Whitman - Hewlett-Packard Company - CEO

Well as I mentioned, we have turned the investigation over. Our internal investigation is ongoing and we've got more work to do there but we have turned over the investigation to the SEC Enforcement Division in the United States and the security -- the Serious Fraud Office in the UK, and that process is under way. It will take some time.

I think we all know that the legal system in both countries, this will take a long time to work through, but we are committed to seeking redress for the benefit of our shareholders and it will take some time, Shannon. I suspect this is a multi-year journey through the courts in both countries.

Shannon Cross - Cross Research - Analyst

Just to be clear, you wait to get whatever they do and then you pursue civil charges?



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Meg Whitman - Hewlett-Packard Company - CEO

Basically yes. As I understand this and I'm relatively new to this, is that the SEC and the Serious Fraud Office will make a determination as to whether to pursue this case and then they will come and look at what we have and what the other parties say, and will carry that on.

Shannon Cross - Cross Research - Analyst

Great. Thank you.

Meg Whitman - Hewlett-Packard Company - CEO

Great.

Rob Binns - Hewlett-Packard Company - VP, IR

Thanks Shannon.

Meg Whitman - Hewlett-Packard Company - CEO

Well thank you very much for listening this morning. Thank you for coming on in the beginning of the day as opposed at the end of the day, and we look forward to talking with you all more. Thank you very much.

Operator

Ladies and gentlemen, this concludes our call for today. Thank you.

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